

1999 Country Reports on Economic Policy and Trade Practices

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EL SALVADOR

Key Economic Indicators
(Millions Of U.S. Dollars Unless Otherwise Indicated)

	1997	1998	1999 1/
Income, Production and Employment:			
Nominal GDP	11,305.0	11,870.2	12,368.0
Real GDP Growth (Pct)	4.2	3.2	2.5
GDP By Sector:			
Agriculture	1,492.0	1,432.2	1,475.0
Manufacturing	2,400.0	2,629.4	2,760.0
Services	6,449.0	6,878.0	7,290.0
Government	747.0	800.0	848.0
Per Capita GDP (US\$) 2/	1,897.0	1,968.0	2,025.0
Labor Force (000s) 3/	2,260.0	2,305.0	2,350.0
Unemployment Rate (Pct) 4/	7.6	8.0	8.0
Money and Prices (Annual Percentage Growth):			
Money Supply Growth (M2)	20.0	12.0	9.0
Consumer Price Inflation	2.0	4.2	4.0
Exchange Rate (Colon/US\$)	8.75	8.75	8.75
Balance Of Payments And Trade:			
Total Exports Fob 5/	2,425.0	2,446.0	2,400.0
Exports To U.S. 5/	1,312.0	1,454.0	1,555.0
Total Imports CIF 5/	3,740.0	3,959.0	4,150.0
Imports From U.S. 5/	1,975.0	2,028.0	2,150.0
Trade Balance	-1,325.0	-1,513.0	-1,750.0
Balance With U.S.	-633.0	-554.0	-595.0
External Public Debt	2,680.0	2,630.0	2,500.0
Fiscal Deficit/GDP (Pct)	2.0	2.0	2.5
Current Account Deficit/GDP (Pct)	-1.9	-0.7	-0.9
Debt Service Payments/GDP (Pct)	3.0	3.0	3.0
Gold and Foreign Exchange Reserves	1,462.0	1,765.0	1,840.0
Aid From U.S.	38.0	38.0	56.8

Aid From All Other Sources 6/	38.0	38.0	38.0
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1/ 1999 figures are central bank estimates based on August data.

2/ Per capita growth based on 1992 census data.

3/ Economically active population, i.e. all those over age 15.

4/ Figures do not include underemployment.

5/ Including gross maquila.

6/ Grants only; figures do not reflect NGO assistance and bilateral loan programs.

1. General Policy Framework

In 1998, El Salvador's economy grew by 3.2 percent, compared to the 4.2 percent growth posted in 1997. The damage caused by Hurricane Mitch to infrastructure and to agriculture production reduced 1998 growth by an estimated 0.5 percent. Growth weakened further in 1999 due to poor international prices for El Salvador's principal export commodities, weak exports to Central American neighbors recovering from Hurricane Mitch, and an investment slow-down caused by the March 1999 presidential elections and delays in legislative approval of a national budget.

Data from the second and third quarter of 1999 indicates the economy has started to recover from the evident slow-down observed during the first quarter of the year. Ministry of economy/central bank data shows that the GDP has gradually risen from 2.1 percent growth in the first quarter to 2.4 percent growth in the third quarter. Growth has been led by the commerce, energy, finance, and manufacturing sectors. During the January-September 1999 period, exports decreased by 4 percent compared to 1998, while imports increased by 6 percent. Value added tax (vat) collections increased during the same period by 6 percent. This modest recovery has taken place within the context of a relatively low inflation rate, which is expected to be 4.0 percent in 1999, compared to 4.2 percent in 1998 and 2.0 percent in 1997. The official outlook for 2000 is for continued macro economic stability with 3.5 percent growth, 2.5 percent inflation and a fiscal deficit of 2.4 percent of the GDP. Economic performance may strengthen more next year if international assistance for Mitch reconstruction projects arrives in a timely fashion, and if the U.S. congress approves expanded Caribbean Basin Initiative (CBI) benefits.

The central bank tightened monetary policy in 1999. The money supply is expected to expand 9 percent in 1999 compared to 12 percent in 1998. Interest rates on loans for less than a year have remained at 15 to 16 percent in 1999, compared to 18 percent two years ago. Medium and long-term interest rates also went down from 20 to 18 percent in the same period.

In 1998, the government successfully privatized the state telephone company, the electricity distribution companies and pension funds. In 1999 the government successfully auctioned the thermal power plants and plans to sell its remaining shares in the telephone company. The 1999 US\$2 billion central budget continues to shift spending from military to social investments, with about one third of the central budget dedicated to social development including health, education and public works. The 1999 budget is likely to result in a fiscal deficit no greater than 2.5 percent of GDP due to improved tax collection. The modest deficit has been financed with official domestic and external bonds. By law, the central bank is not allowed to finance government deficits. The 2000 budget is expansionary, and its spending is expected to increase by 6 percent over the 1999 budget.

1998 brought a slight increase in both exports (1 percent) and imports (5.8 percent). As in previous years, family remittances and external aid have offset the large structural trade deficit

in El Salvador. Remittances continue to be the second most important source of foreign exchange after exports and a major factor in El Salvador's macro economic stability. Remittances are increasing at an annual rate of 6.5 percent, and an estimated 1.35 billion dollars will enter the national economy during 1999.

2. Exchange Rate Policy

The colon has been informally pegged at 8.75 per dollar since 1994. Large inflows of dollars from Salvadorans working in the United States offset a significant trade deficit. At the end of September 1999, net international reserves at the central bank were 1.8 billion dollars, one of the highest levels in history.

3. Structural Policies

The United States is El Salvador's main trade partner. Imports from the U.S. have increased an average of 16 percent per year since 1993. Imports from the U.S., which constitute about 50 percent of all El Salvador's imports, are projected to reach \$2.15 billion in 1999, up from \$2.02 billion in 1998. Key to this trend is the multi-year program (whose last phase concluded in July 1999), to radically lower tariff barriers. Under this program, tariffs for most capital goods and raw materials have been reduced to zero or one percent, and tariffs on intermediate and final goods have been reduced to a maximum rate of 15 percent.

In September 1997, the government launched a new, simplified customs procedure system that reduces the former cumbersome 20-step import process to seven steps. A second stage of this customs modernization program, consisting of processing import/export papers via computer/satellite from the user's office, was implemented in November 1998, and a final stage to facilitate electronic payment of import duties was launched in February 1999. Close to 80 percent of all Salvadoran imports consist of capital and intermediate products. The government has an open procurement policy in practice, and U.S. companies compete actively for contracts.

El Salvador has liberal legislation under which it has privatized the state owned telephone company (Antel), four electricity distributors and two thermal generating companies, and pension funds. All of these projects represent good opportunities for U.S. suppliers and investors.

Prices, with the exception of bus fares and utilities, which are moving toward market prices, are unregulated. A commission to monitor the telecommunications and electric sectors (Siget) has been established.

The 13 percent value-added tax (vat) is applied to all goods and services, domestic and imported, with a few limited exceptions for basics like dairy products, fresh fruits and vegetables, and medicines. In September 1999, the vat and income tax laws were reformed in order to expand the country's taxable base and increase government revenues. At the end of 1994, the

government replaced a price band mechanism, introduced in 1990 to regulate the tariffs on basic grains. The government policy on basic grain tariffs is set by seasonal supply and demand conditions in the local market. Currently, yellow corn is imported duty free; white corn enters duty free from February 1 through July 31, and is subject to 15 percent ad-valorem rate from August 1 to January 31. Paddy (rough) rice pays 20 percent ad-valorem, and milled rice, 35 percent.

4. Debt Management Policies

El Salvador has traditionally pursued a conservative debt policy. External debt stood at \$2.630 billion at December 1998, a 2 percent below the previous year. The total external debt is expected to fall slightly to \$2.5 billion by the end of 1999. Almost 70 percent of this debt has been contracted with international financing institutions, and 30 percent with bilateral organizations and other sources. The debt service in 1999 amounted to \$309 million or 2.5 percent of the GDP, and is considered moderate. El Salvador's prudent debt policies have been recognized by improved risk ratings on its official debt instruments by organizations such as Moody's and Standard and Poor's.

El Salvador has succeeded in obtaining significant new credits from diverse international sources over the last three years. Some \$300 million has been contracted from international institutions and governments (Spain, Germany, Japan) for infrastructure works and social programs to be undertaken over the next few years. In August 1999, El Salvador successfully placed US\$150 million in Euro-bonds. The debt profile is expected to increase over the next several years as the international donor community has pledged 1.26 billion dollars to finance El Salvador's reconstruction and modernization.

5. Aid

Aid grants from the U.S. totaled \$56.8 million in 1999. Bilateral military assistance (international military and educational training) from the U.S. totaled \$500,000 in 1998 and \$500,000 in 1999.

6. Significant Barriers to U.S. Exports

There are no legal barriers to U.S. exports of manufactured goods or bulk, non-agricultural products to El Salvador. Most U.S. goods face tariffs from 0 to 15 percent. The range for category is 0 to 5 percent for capital goods, 5 to 10 percent for intermediate products, and up to 15 percent for final goods. Higher tariffs are applied to automobiles, alcoholic beverages, textiles and some luxury items, but the Salvadoran government also plans to gradually reduce these tariffs in the near future.

Generally, standards have not been a barrier for the importation of U.S. consumer-ready food products. Poultry is the notable exception; since 1992, the government has imposed a zero

tolerance requirement for several common avian diseases such as salmonella, effectively blocking all imports of U.S. poultry. The Ministry of Agriculture (MAG) requires a salmonella-free certificate showing that the product has been approved by U.S. health authorities for public sale. Importers may also be required to deliver samples for laboratory testing, but this requirement has not been enforced. However, lately MAG is requesting plant inspections at origin to allow imports of various food products into the local market. The cost for this procedure has to be paid by the exporter or the local agent/distributor. A sanitary certificate must accompany all fresh food, agricultural commodities and live animals. Basic grains and dairy products also must have import licenses. Authorities have not enforced the Spanish language-labeling requirement.

El Salvador is a member of the WTO and expects to implement a full range of its Uruguay round commitments on schedule. The government is an active participant in the Summit of the Americas/Free Trade of the Americas process. The country is a member of the Central American common market, and together with Guatemala and Honduras, is negotiating a free trade agreement with Mexico. A free trade agreement is being negotiated with Chile, and limited scope free trade agreement has been signed with the Dominican Republic.

El Salvador officially promotes foreign investment in virtually all sectors of the economy. Foreign investment laws allow unlimited remittance of net profits, except for services where the law allows 50 percent. No restrictions exist on establishing foreign banks or branches of foreign banks in El Salvador. Recently, the legislative assembly approved a new more open and modern investment promotion law, as well as a new banking law.

7. Export Subsidies Policies

El Salvador does not employ direct export subsidies. It offers a 6 percent rebate to exporters of non-traditional goods based on the fob value of the export, but some exporters have found it difficult to collect. Free trade zone operations are not eligible for the rebate but enjoy a 10-year exemption from income tax as well as duty-free import privileges.

8. Protection of U.S. Intellectual Property

El Salvador belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO), and is a signatory to the Paris Convention, Bern Convention, Rome Convention, Phonograms Convention, and the Nairobi Treaty.

In 1998 and 1999, the intellectual property office of the attorney general's office took strong enforcement measures against IPR violators in a number of areas including, videos and music cassettes, medicines, and clothing. Starting in 1999, officials began raids on software pirates.

El Salvador's current law protecting intellectual property rights took effect in October 1994. This law, along with El Salvador's acceptance of TRIPS disciplines, addresses several

weak areas. Patent terms were extended to 20 years, and the definition of patentability was broadened. Compulsory licensing applies only in cases of a national emergency. Computer software is protected, as are trade secrets.

Trademarks are still regulated by the Central American Convention for the Protection of Industrial Property. It is an occasional practice to license a famous trademark and then seek to profit by selling it when the legitimate owner wants to do business in El Salvador. In November 1994, El Salvador signed an amended version of the convention, which, among other things, would address this issue. The revised convention will take effect upon ratification by three of the participating Central American governments. According to Salvadoran government officials, they are working on a draft for a separate semiconductor chip law.

With international funding, the government is completing a comprehensive reorganization of its antiquated national registry office. The registration process has been simplified and computerized, and significant progress is being made in reducing backlogs and adjudicating disputes.

9. *Worker Rights*

a. Right of Association: the constitution prohibits the government from engaging in antiunion actions against workers trying to organize and the 1994 labor code streamlined the process required to form a union in the private sector. Unions and strikes are legal only in the private sector. Employees of autonomous public agencies may form unions but not strike. Nevertheless, many workers including those in the public sector form employee associations that frequently carried out strikes that, while technically illegal, were treated as legitimate. Approximately 20 percent of the workforce are members of unions, public employees associations, or peasant organizations.

b. The Right to Organize and Bargain Collectively: the constitution prohibits the government from using nationality, race, sex, creed, or political philosophy as a means to prevent workers or employees from organizing themselves into unions or associations. In practice, the government has generally respected this right. El Salvador has a small organized labor sector with approximately 150 active unions, public employee associations, and peasant organizations, representing over 300,000 citizens, or 20 percent of the total work force. By law, only private sector workers have the right to organize unions and strike. Some employees of autonomous public agencies may form unions if they don't deal with essential services. Public employees may form employee associations, but are prohibited from striking. In fact, some of El Salvador's most powerful labor groups are public employees associations, which take on the same responsibility as unions -- including calling technically illegal strikes and collective bargaining. The government negotiates with these associations and generally treat strikes as legitimate, although the labor code mandates arbitration of public sector disputes. The constitution and the labor code provide for collective bargaining rights, but only to employees in the private sector

and in autonomous government agencies. In fact, both private sector unions (by law) and public sector employee associations (in practice) use collective bargaining.

c. Prohibition of Forced or Compulsory Labor: the constitution prohibits forced or compulsory labor, except in the case of calamity and other instances specified by law. This provision is followed in practice. Although not specifically prohibited, forced and bonded labor by children are covered by the general prohibition, and there were no reports of its use in the formal sector. However, there is strong evidence that minors are forced into prostitution.

d. Minimum Age for Employment of Children: the constitution prohibits the employment of children under the age of fourteen. The labor code specifically prohibits forced and bonded labor in general, but does not specifically cover children. Minors fourteen or older may receive special labor ministry permission to work, but only where such employment is absolutely indispensable to the sustenance of the minor and his family. This is most often the case with children of peasant families who traditionally work during planting and harvesting seasons. Child labor is not usually found in the industrial sector. Those legal workers under the age of eighteen have special additional rules governing conditions of work.

e. Acceptable Conditions of Work: the minimum wage was increased by 10 percent in 1998. Effective April 1998, the minimum wage is \$4.80 (42 colones) per day, for commercial, industrial, and service employees. It had remained at \$4.40 (38.50 colones) per day since 1995. For agricultural workers, it was raised to \$2.47 from \$2.26, plus a food allowance, per day. Minimum wage for workers at coffee mills was increased to \$3.56 from \$3.30 per day, and for sugar mill workers to \$2.60 from \$2.26 per day. The law limits the workday to 6 hours for youths between fourteen and eighteen years of age and 8 hours for adults, and it mandates premium pay for longer hours. The labor code sets a maximum normal workweek of 36 hours for youths and 44 hours for adults.

f. Rights in Sectors with U.S. Investment: U.S. investment in El Salvador has increased in recent years, especially in the energy and financial sectors. The labor laws apply equally to all sectors, including the so-called “maquilas” or free trade zones (FTZ). During the last few years, most FTZ companies have accepted the provisions of voluntary codes of conduct from their parent corporations or U.S. purchasers. These codes include worker rights protection clauses. In April 1997, the Salvadoran Apparel Industry Association (ASIC) announced an industry wide code of conduct, currently being implemented, with worker rights protection. The great majority of workers in the FTZs receive much better salaries and working conditions than are offered elsewhere in the private sector. Nevertheless, there were credible reports of factories dismissing union organizers. In addition, accusations persist of some companies abusing their workers. This year, the labor ministry increased the number of inspectors and inspections, improved the professional training of the inspector corps, and made a better effort to follow up on such complaints.

Extent of U.S. investment in selected industries -- U.S. direct investment position abroad on an historical cost basis -- 1998

(Millions of U.S. Dollars)

Category	Amount
Petroleum	194
Total Manufacturing	26
Food & Kindred Products	10
Chemicals & Allied Products	12
Primary & Fabricated Metals	13
Industrial Machinery and Equipment	0
Electric & Electronic Equipment	-15
Transportation Equipment	0
Other Manufacturing	6
Wholesale Trade	(1)
Banking	18
Finance/Insurance/Real Estate	(1)
Services	8
Other Industries	169
Total All Industries	599

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.